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Supreme Court of the United States

October Term, 1962

No. 70

IRVING J. WOLF, ROBERT H. DAVIDSON, RICHARD S. HULL and FREDERICK KATZENELL,
Petitioners,

against

ARNOLD A. WEINSTEIN, JEROME FRIED, NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC., *et al.*,
Respondents.

In the Matter

of

NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC.,
Debtor.

REPLY BRIEF FOR PETITIONERS

On Writs of Certiorari to the United States Court of Appeals for the Second Circuit

In Proceedings for the Reorganization of a Corporation
TWO CASES (No. 26362 and No. 27000)

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In Proceedings for the Reorganization of a Corporation TWO CASES (No. 26362 and No. 27000)

No. 27000—The Respondents' Tergiversation and the Strangers' Fraud

The reasons for the Court of Appeals decision, as expressed in Judge Moore's opinion, have been abandoned by the respondents. They urged upon the Court of Appeals the conclusions of law there adopted. Now they propose new

conclusions, which differ radically from the conclusions of both Courts below. They also propose new findings of fact, in addition to the findings which the Court of Appeals erroneously substituted for the District Court's. Now, in rationalizing the result they obtained below, Weinstein and Fried and the Debtor's attorney, Mr. Rosen, differ radically among themselves. They agree only on avoiding applicable state law, on advocating no-law as the rule of decision, and on pressing to impose on 6 of the 36 stock-claimants a loss caused by a stranger to the proceedings, though all 36 had acquired their Nazareth stock from that same stranger under legally identical circumstances, and though all 36 were equally victims and innocent of fraud.

1. *Rules of Decision*: The answering briefs require that the issues be stated again. The Question Presented to this Court in No. 27000, is: "In a Chapter X reorganization proceeding, in adjudicating claims to stock interests in the debtor, which interests vested under state law prior to commencement of the reorganization proceedings, and where no supervening federal statute or policy exists: Is the federal court (having non-diversity jurisdiction) required to apply state rules of decision in equity? If so, does the application of such state rules of decision extend to remedies as well as rights?" (Wolf Brief at 3)

(a) *Respondents' Answers*: Respondents seem to offer three answers, in the alternative, to the Question Presented. (i) Sometimes they seem to answer, flatly, *No.* That answer would confine the Rules of Decision Act, despite its language, to *diversity* civil actions, for no reason but bankruptcy practice and the alignment of parties. Further discussion is unnecessary (Wolf Brief at 58-80). (ii) Sometimes they seem to answer: *Yes, but* there is *no conflict* of state law and the "federal general equity" applied below. That answer depends on the Weinstein-Fried error in reading the Pennsylvania Business Corporation Law and cases (*discussed infra*, p. 24). (iii) Sometimes they seem to answer: *Yes, and* there

is a conflict of state and federal laws here, *but* federal law is supreme, and a supervening federal policy does exist, *viz.*: *rectify fraud!* That answer disregards the author of the fraud, and implicitly answers a major substantive question here, *viz.*: Does a stranger's fraud invoke certain defenses and remedies of "federal general equity"—particularly the "clean hands" defense and "piercing the corporate veil"—to nullify stockholders' rights vested under applicable state law?

(b) *Fraud and Federal Law*: Fraud there was in the issuance of the outstanding Nazareth stock—committed by John Malakoff *alone*. He died, insolvent, in 1955, never a party to these proceedings. There is no charge—much less proof—that any of the 6 aggrieved stockholders in No. 27000 participated in Malakoff's frauds, or that any of the 6 knew of Malakoff's frauds until Malakoff failed and withdrew from Nazareth—after all the Nazareth stock had been bought, paid for, issued, and delivered. The District Court, in allowing all 36 stock-claims, found no participation in Malakoff's frauds, and no knowledge thereof (with a single reservation as to Fried [R. 157-8, 243]). The Court of Appeals, in disallowing the claims of the 6 aggrieved stockholders, made no finding—or suggestion—of such participation or knowledge.

(c) *"Clean Hands" and "Piercing the Corporate Veil":* Respondents' disquisitions on the truism that a bankruptcy court is an equity court with statutory jurisdiction and inherent power to disallow or subordinate claims "based on • • • an illegal or criminal transaction" (Fried Brief *at* 43) are essentially a reference to the power of an equity court to refuse relief to a plaintiff with "unclean hands." That power is as ancient and inherent as the contempt power. But the doctrine applies to the *litigant's* "hands." It is the wrongdoing of the plaintiff—*not* the wrongdoing of a stranger—which denies a remedy otherwise due the plaintiff by law.

> "* * * That doctrine is rooted in the historical concept of court of equity as a vehicle for affirmatively enforcing the requirements of conscience and good faith. This presupposes a refusal on its part to be 'the abettor of iniquity.' [Case cited.] Thus while 'equity does not demand that its suitors shall have led blameless lives,' [case cited], as to other matters, it does require that they shall have acted fairly and without fraud or deceit as to the controversy in issue. [Case cited.]" [1]

The Chapter X procedure authorizes a "bar order" under § 196,[2] and, in effect, compels a "property" owner (including a stockholder) to file a proof of claim to confirm his title to property in judicial custody. He thereby becomes a plaintiff (so to speak), subject to the "clean hands" doctrine. That is the only substantive effect of bankruptcy procedure and practice.

"Piercing the corporate veil" is kindred or subsumed. The object is to impute an agency relationship or to void a fraudulent conveyance. The crucial elements are fraud and domination—by the litigant, not by a stranger.[3]

If the 6 aggrieved stockholders were themselves guilty of such fraud as would warrant the application of the "clean hands" doctrine, this case would be at an end; indeed, the grant of *certiorari* would have been improvident. It would be frivolous to question a federal court's independent power—and duty—to invoke the doctrine. But the 6 aggrieved stockholders were *not* guilty of fraud. They did *not* share Malakoff's domination and control of Nazareth. They com-

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[1] *Precision Instrument Mfg. Co. v. Automotive Maintenance Mach. Co.*, 324 U. S. 806, *at* 814-5 (1945, *per* Murphy, *J.*).

[2] *Bankruptcy Act*, § 196; 11 U. S. C. § 596; 52 Stat. 893 (1938).

[3] *See Taylor* v. *Standard Gas & Electric Co.* ["*Deep Rock*"], 306 U. S. 307 (1939, *per* Roberts, *J.*); *Pepper* v. *Litton*, 308 U. S. 295 (1939, *per* Douglas, *J.*); *Sampsell* v. *Imperial Paper & Color Corp.*, 313 U. S. 215 (1941, *per* Douglas, *J.*); *Berkey* v. *Third Ave. Ry. Co.*, 244 N. Y. 84, 155 N. E. 58 (1926, *per* Cardozo, *J.*).

mitted *no* "wrongful or injurious conduct".[4] They had *no* "knowledge as to the [putative] fraudulent character of [Malakoff's] corporation."[5] If Malakoff's transfers of Nazareth stock were fraudulent as against his creditors, the 6 had no knowledge of such fraud, and their antecedent debts were "fair consideration" and "value".[6] The 6 are not seeking priority over the 30 prevailing stock-claimants or any creditors of Malakoff's or Nazareth's. They are seeking parity.[7]

The "clean hands" doctrine is irrelevant. There is no occasion to "pierce the corporate veil". There ends the inherent and independent power of a bankruptcy court, as a court of equity, to disregard the corporate entity or to disallow claims in *Nazareth*.

(d) *Corporate Shares as Stockholders "Property"—Definition by State Rules of Decision*: In *Pearlman* v. *Reliance Insurance Co.*,[8] Mr. Justice Black wrote:

> "* * * Ownership of property rights before bankruptcy is one thing; priority of distribution in bankruptcy of property that has passed unencumbered into a bankrupt's estate is quite another. * * * The Bankruptcy Act simply does not authorize a trustee to distribute other people's property among a bankrupt's creditors. * * * This Court has recently reaffirmed that such property rights existing before bankruptcy in persons other than the bankrupt must be recognized

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[4] *Taylor* v. *Standard Gas & Electric Co.*, *supra*, n. 3, 306 U. S. *at* 322.

[5] *Sampsell* v. *Imperial Paper & Color Corp.*, *supra*, n. 3, 313 U. S. *at* 217, 221.

[6] *Bankruptcy Act*, § 67d(1)(e); 11 U. S. C. § 107(d)(1)(e); 52 Stat. 876 (1938); *Uniform Fraudulent Conveyance Act*, § 3; N. Y. D. & C. L. (12 McKinney's N. Y. Consol. L.), § 272; L. 1925, c. 254, § 1.

[7] *Cf. Sampsell* v. *Imperial Paper & Color Corp.*, *supra*, n. 3.

[8] *Pearlman* v. *Reliance Ins. Co.*, U. S. , 9 L. ed. 2d 190 (1962, *per* Black, *J.*; Clark, *J.*, *concurring*).

> and respected in bankruptcy. [Footnote 11] Consequently our question is not who was entitled to priority in distributions under § 64, but whether the surety had, as it claimed, ownership of, an equitable lien on, or a prior right to this fund before bankruptcy adjudication." [9]

Footnote 11 to that opinion in *Pearlman*, cited *Durham Lumber*[10] and *Aquilino*.[11] In the latter, Mr. Chief Justice Warren had written:

> "* * * The application of state law in ascertaining the taxpayer's property rights and of federal law [I. R. C. § 6323] in reconciling the claims of competing lienors is based both upon logic and sound legal principles. This approach strikes a proper balance between the legitimate and traditional interest which the State has in creating and defining the property interest of its citizens, and the necessity for a uniform administration of the federal revenue statutes." [12]

Where "property" is defined by state law, a dispute over the definition of "property" is defined by state rules of decision.

To determine *What* is property, is also to determine *Who* owns that property. When two persons claim the same property, and the controversy arises from transactions with a judgment-proof third person, the definition of "property" also determines priority to a limited fund for payment or indemnification—and further distributes or imposes business losses. The bankruptcy court, like a diversity court, yields to state law on those questions. *Nazareth* presents the same questions to the Chapter X court as to ownership of corporate stock in a solvent debtor.

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[9] *Id.*, 9 L. ed. 2d *at* 193.

[10] *U. S. v. Durham Lumber Co.*, 363 U. S. 522 (1960, *per* Warren, *C. J.*).

[11] *Aquilino* v. *U. S.*, 363 U. S. 509 (1960, *per* Warren, *C. J.*).

[12] *Id.*, 363 U. S. *at* 514.

Change one element of *Pearlman, Aquilino* and *Durham Lumber*: Suppose the claimants' losses had been incurred, and the fund had been insufficient, because of the *fraud* of an agent of the corporate bankrupt, *not* because of honest business failure. The bankrupt and the defrauding agent are still not claimants to the fund. Would state rules of decision no longer determine ownership of the fund? The respondents in *Nazareth* would answer, Yes. That is their case here.

2. *Validity of 200 Outstanding Shares of Nazareth Stock*: The foundation for the decision below was that *all* outstanding shares of Nazareth stock were *void* for lack of consideration to the issuer. Judge Moore wrote (*e.g.*):

> "* * * These shares as a matter of Pennsylvania law could have had no validity as an original issue. * * *" (R. 591)

> "* * * But no such shares were ever validly issued to Malakoff. * * * There is no proof that Malakoff ever paid for these shares or that they were legally issued. * * * The purported issuance was both fraudulent and invalid." (R. 592)

> "* * * The Debtor's stock for all practical purposes has never been legally issued. * * *" (R. 593)

Now the respondents concede—indeed, Weinstein and Fried urge—that up to 200 issued and outstanding shares of Nazareth stock were *valid*, not void.

> "* * * In the present case the Court of Appeals *could not void* the capital stock. * * *" (Fried Brief *at* 35, n.; *emphasis supplied*)

> "* * * the mere fact that all the issued stock of the corporation stood in Malakoff's name did not make Malakoff and the corporation one and the same person. It continued as an entity irrespective of him. [Cases cited.]" (Debtor Brief *at* 31)

The issued and outstanding Nazareth shares within the authorized limit of 200 shares of stock, were valid. (Wolf Brief *at* 80-100)

3. *Inadequacy and Abandonment of Purchase-Money Resulting Trust*: Having voided all the outstanding Nazareth stock, the Court of Appeals impressed a purchase-money resulting trust on the Market—realty and business—in favor of all 30 prevailing stock-claimants who had allegedly paid the purchase price through Malakoff to the Philadelphia Group. Judge Moore wrote:

> "* * * One group of investors paid Malakoff by check, credit or cash various sums to purchase an interest in the Nazareth *Market*. * * *" (R. 591; *emphasis supplied*)
>
> "Malakoff received the moneys put into his hands by the investors for the specific purpose of the allotment of shares in the Nazareth *Market property. He used some of this money to acquire that property.* Title thereto now is in the Debtor. The court upon reorganization is in a position to give to the investors that which they were originally entitled to receive." (R. 593; *emphasis supplied*)

There are two major legal impediments to the purchase-money resulting trust impressed by the Court of Appeals. One is the New York statute abolishing that form of trust on *realty*. The other is the Pennsylvania (and general) doctrine that no person can qualify as a *cestui* of such a trust unless he had paid the trustee *before* the trustee himself had paid over the purchase money to the seller of the property which is the subject of the trust. Thus, even under Judge Moore's rationale, since Malakoff's last payment of the purchase money to the Philadelphia Group occurred on or before February 15, 1952, those stock-claimants who paid Malakoff *subsequently* could not qualify as *cestuis*—and that would

disqualify almost half the "investors" whose stock-claims were (nevertheless) allowed by the Court of Appeals.

The respondents cope with those two impediments by circumvention; and in doing so, they separate. Weinstein and Fried, having conceded the validity of the Nazareth stock, would now impress the resulting trust on the stock, not on the realty. Besides, they say, New York law would establish the same trust, labelled "constructive trust", because Malakoff was more than a bare recipient of the purchase money. Whether "resulting" or "constructive", the trust could benefit only half the 30 prevailing stock-claimants; for the rules about payment of the purchase-money are the same as to both types of trust in both Pennsylvania and New York.[12a] So Weinstein and Fried acknowledge. Therefore, the other half—or perhaps all 30—are to get their stock-claims allowed by a different route, *estoppel*—not even alluded to by Judge Moore.

> "* * * While the present facts bear more of the characteristics of a resulting than of a constructive trust, unquestionably the New York courts would impose a trust for the benefit of the investors. This trust would be imposed not upon the real property, * * *, but upon the Debtor's capital *stock*. [Footnote:] * * * Here it might be said that the Market on arrival at the corporation was converted from real to personal property." (Fried Brief *at* 34-5; *emphasis supplied*)
>
> "The availability of an *estoppel* to all who made an investment through Malakoff after August 1, 1951, eliminates from the case the question whether those who invested with him after he ceased making payments for the acquisition of the Market on February

[12a] *Foreman* v. *Foreman*, 251 N. Y. 237, *at* 242, 167 N. E. 428 (1929, *per* Cardozo, *C. J.*); *Leary* v. *Corvin*, 181 N. Y. 222, 73 N. E. 984 (1905, *per* Cullen, *C. J.*); *Petrukevich* v. *Maksimovich*, 1 A. D. 2d 786, 147 N. Y. S. 2d 869 (2d Dept., 1956, *memo*). *See* Wolf Brief *at* 110-4.

15, 1952 [footnote], may share with the earlier subscribers in the trust of the corporation's capital *stock*." (Fried Brief *at* 38; *emphasis supplied*)

Unlike Weinstein and Fried, Mr. Rosen does not advocate the purchase-money resulting trust even as an alternative remedy. He, too, concedes that at least 20, and up to 200, Nazareth shares, remain valid and outstanding, and that Malakoff held title to those shares. He, too, would impress a trust on all those shares. But Mr. Rosen's trust requires that the Court, "to do equity", should "pierce the corporate veil" and disregard the corporate entity of his client, Nazareth. He wants this Court to treat Nazareth as a joint venture. Malakoff's trust would arise from Malakoff's being the managing partner of a business enterprise—but without a share of his own. The stock-claimants judicially allowed to participate in Nazareth stock, would be those who made "actual contributions" to the venture. But "contribution" to the "venture" would not be Judge Moore's "contribution" to the purchase price of the Market (the subject of the venture).

"* * * Malakoff was holding those 20 shares for the benefit of his principals who furnished the money for whatever he acquired, * * *." (Debtor Brief *at* 31)

"The fact that some investors gave Malakoff monies for investment in the *Nazareth venture* before, during or after the purchase of Nazareth, and that he gave more interests than he represented were to be distributed or more shares of stock than were authorized to be issued, becomes academic because his purchase enures to the benefit of all investors or subscribers in proportion to their *actual contribution* [case cited]. * * *

"The stock claimants would be treated as what they truly were—investors as venturers in a *joint venture* with Malakoff as managing venturer.

> "The *res* of their investment * * * would clearly not be the corporation but the Nazareth business and realty." (Debtor Brief *at* 45; *emphasis supplied*)

Under Pennsylvania law, New York law, and "general equity", a purchase-money resulting trust cannot exclude the 6 aggrieved stock-claimants, yet include half the 30 prevailing stock-claimants who made their advances to Malakoff subsequent to Malakoff's last payment of the Market's purchase price to the Philadelphia Group. (Wolf Brief *at* 109-115)

4. *Inadequacy and Abandonment of Judge Moore's Grounds for Excluding 6 Aggrieved Stockholders*: The Court of Appeals excluded the 6 aggrieved stockholders, and cancelled their Nazareth shares, because—and only because—their consideration for those shares consisted of credit to Malakoff against his personal antecedent debts to them, and/or investment exchanges with Malakoff personally. If Malakoff (individually or as agent or trustee) held *title* to any valid Nazareth stock, Malakoff could have transferred good title, even in fraud of his *cestuis*, to the 6 as purchasers without notice and for "value"—and "an antecedent or pre-existing obligation * * * constitutes value" in the sale of corporate shares.[13] Hence, Judge Moore's theory required that all the Nazareth stock be absolutely void, and that Malakoff be selling realty, not corporate stock.

> "The Examiner treated Malakoff as the owner and operator of the Debtor and each claimant as having purchased his interest from Malakoff. This erroneous assumption made it possible for the Examiner to accept the stock claims of all claimants who had received stock from Malakoff on the theory that stock transfers

[13] *Uniform Stock Transfer Act*, § 22(1); N. Y. P. P. L. (L. 1913, c. 600) (40 McKinney's N. Y. Consol. L.) § 183(1); 15 Purdon's Pa. Stats. Ann. § 322(1), P. L. 126, § 22(1) (1911). (*See* R 592, n. 3.)

> from Malakoff rested upon adequate consideration if the Stock Transfer Act's definition of 'value' were satisfied. This, however, is not the problem. The Debtor's stock for all practical purposes has never been legally issued. * * * " (R. 593; *accord*: R. 592)

By making *personalty*—valid Nazareth shares—the subject of their respective trusts, and by vesting title in Malakoff, the respondents have side-stepped the New York statute which abolishes resulting trusts on realty only. But in doing so, the respondents have undercut Judge Moore's *sole legal* grounds for reversing the District Court and excluding the 6 aggrieved stockholders, *viz.*: (i) that antecedent debts are not "value" for a good-faith purchase of *realty* from a trustee (*see* Wolf Brief *at* 81-88); and, (ii) that the *realty* constituting consideration for valid Nazareth stock issued under a plan of reorganization, could be earmarked against particular shares (*see* Wolf Brief *at* 88-94).

Having abandoned Judge Moore's rationale altogether, the respondents have had to fabricate different rationales for the result decreed below. At least two emerge.

5. *Malakoff's Capacity—Stockholder-Seller or Triple Agent?* Judge Moore concluded that " * * * Malakoff * * * must be regarded as a trustee, * * *, agent, * * * for those who gave him their funds for investment in the project" (R. 592-3), *i.e.*, as purchase-money resulting trustee for all 30 prevailing stock-claimants in the purchase of the Market realty from the Philadelphia Group as sellers. That conclusion reversed the findings and conclusions of the District Court that " * * * Malakoff [was] the owner and operator of the Debtor and each claimant [had] purchased his interest from Malakoff." (R. 593) Now the respondents propose two different theories of Malakoff's capacity in the Nazareth stock transactions.

(a) *The New Independent Weinstein-Fried Theory—Estoppel*: Weinstein and Fried would raise a purchase-money

resulting trust (or constructive trust)—but on the Nazareth stock, not on the realty, and only for the benefit of half the 30 prevailing stock-claimants. Even Weinstein and Fried cannot guess which of the 30 are true *cestuis*, and for how much in cases where "investments" were made with Malakoff both before and after February 15, 1952 (*e.g.*, Aaron Fried [Fried's father], R. 126-9). Whoever the later "investors" are, they cannot be true *cestuis* of a trust of valid Nazareth stock. Under the Weinstein-Fried theory, their stock is void for lack of consideration to Nazareth.

So Weinstein and Fried advance their estoppel theory. Estoppel, they say, would be available to all 30 prevailing stock-claimants, and would thus obviate identification of the true resulting-trust *cestuis*, and would validate whatever stock those 30 claimed. To deny the remedy to the 6 aggrieved stock-claimants, the estoppel theory elicits still another new proposition, *viz.*:

> "* * * the Debtor is compelled to accept claimants as stockholders only if they dealt with Malakoff as agent of the corporation." (Fried Brief *at* 41)

Now Malakoff would be a *double agent*.

Two facts obtrude, *viz.*: the stock-claimants' payments to Malakoff, not to Nazareth; and the Malakoff-Weinstein letter-receipt:

> "* * * all of the authorized stock * * * has been issued to *me*. I am obliged to you for a proportionate share of *my* earnings, * * *.
>
> "In the course of *my* management of the Market, I may cause to be issued to you *n* shares of *my* present stockholdings. * * *" (R. 186-7; *emphasis supplied*)

To escape the meaning that Malakoff was selling his own stock, Weinstein and Fried "read the letter-receipt *closely*", and spell out Malakoff's double agency:

> "* * * [Malakoff's] representation is not that he is selling to the investors shares previously issued to him. The representation is in effect that, as agent of the corporation, Malakoff is issuing to himself, as agent for the investors [footnote], the entire 200 shares of Nazareth." (Fried Brief *at* 38-39)

"Notice" is their bugbear. So Weinstein and Fried argue that an objective reading of the letter-receipt would indicate Malakoff to have been a double-agent, but not an individual seller. Earlier, in the District Court, Weinstein—the draftsman—*swore* that an objective reading would indicate Malakoff to have been an individual seller (R. 362-3), and that he (Weinstein) himself had acted on Malakoff's representations of selling his own shares (R. 120).

Weinstein and Fried still thrust the 30 prevailing stockholders into an agency embrace with Malakoff. The imputation of the agent's knowledge to his principals, they answer by—silence! Meanwhile, they charge the 6 aggrieved stockholders with "notice" of Malakoff's conflict of interest with Nazareth, to deny them an estoppel *vis-à-vis* Nazareth. But the 6 were purchasers from Malakoff, not Nazareth. For them, the only relevant conflict of interest was between Malakoff and the resulting-trust *cestuis* for whom he supposedly held title to valid Nazareth stock. That "trust"—and conflict of interest—were secret.

Estoppel cannot justify the decision below. (*See* Wolf Brief *at* 20-24, 87-88, 101-9, 114.)

(b) *The New Independent Theory of the Debtor—Joint Venture and McCandless* v. *Furlaud*: Surpassing Weinstein and Fried, Mr. Rosen would make Malakoff a *triple agent* in the Nazareth stock transactions, *viz.*: (A) for Nazareth, (B) for all (not some) of the 30 prevailing stock-claimants, and (C) for the Philadelphia Group, too! Notwithstanding both decisions below, says Mr. Rosen, Malakoff was not a pur-

chaser of the Market from the Philadelphia Group; rather, he and they were partners in a criminal conspiracy to defraud Nazareth and the stock-claimants. Now the sellers of the Market to the joint venture would be Harter and Shope (who sold to the Philadelphia Group). (R. 230) The Philadelphia Group, like Malakoff, would be constructive trustees for the 30 prevailing stock-claimants.

All this is impossible to reconcile with either of the decisions below, or with the new Weinstein-Fried theory. Mr. Rosen's conspiracy between Malakoff and the Philadelphia Group is fiction, akin to Mr. Rosen's fiction of a conspiracy between Malakoff and some of the 36 stock-claimants (R. 47-49)—disproved below, and buried at last.

(i) The gravamen of Judge Moore's opinion, and the chief Weinstein-Fried argument, is that *money* alone—if and only if traced into the Market or the corporate treasury—can justify a "share" of Nazareth. Thus, the 6 aggrieved stock-claimants could acquire no shares from Malakoff because he owned none, and he owned none because he paid no money. Hence the reliance on the resulting-trust doctrine and on the corporate laws on consideration for stock.

Mr. Rosen's joint-venture theory requires "contribution to the venture". The money-only index is gone, perforce. Now private contract, express or implied, controls. Pennsylvania and New York do not restrict the forms of consideration for a joint-venture "share" (by contrast to a corporate share). That is a major reason for the vogue of the limited partnership and the joint venture in public real estate "syndicates".[14]

Assuming (*arguendo*) no payment of money by Malakoff, and the need for monetary consideration for corporate shares: The Pennsylvania and New York case-law would validate a partner's share in a joint venture in consideration of (*e.g.*)

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[14] *See op. cit. Wolf* Brief *at* 5, n. 4; Elliott, Shaken to the Foundations: Prospects for Publicly Owned Real Estate Companies, Barron's, 11/26/62, p. 3; 12/3/62, p. 5; 12/10/62, p. 5.

services alone, past or future, or the bare assumption of liabilities.[15] Malakoff "found" and financed the deal; he took no brokerage. He guaranteed Nazareth dividends, and paid out $36,268.02. (R. 189, 232) He operated Nazareth for two years, without salary. No one expected, or could expect, Malakoff to undertake all that for nothing. How much of Mr. Rosen's joint venture Malakoff was originally entitled to, and whether Malakoff's late oversales could void "shares" he had sold earlier to innocent purchasers, are questions on which no findings of fact were made below.

(ii) The veil to pierce is Mr. Rosen's joint-venture theory. Conspiracy and insolvency are the constituents of his procrustean assimilation of *Nazareth* to *McCandless* v. *Furlaud*.[16] His object is to exclude the 6 aggrieved stockholders. He is sublimely indifferent to the distribution of shares among the 30 prevailing stockholders, *e.g.*, Malakoff's return of $2,216.54 (31.665%) in "dividends" on Weinstein's advance of $7,000 (R. 126) does not budge Mr. Rosen in his conception of Weinstein's $7,000 (not $4,783.46) as a joint-venture "investment" (now unrelated to the realty purchase-price). The District Court also adopted a joint-venture theory, but had a radically different view of the "equities". (R. 192-212; Wolf Brief *at* 120-8.)

Leaning on *McCandless*, Mr. Rosen is hoist with his own petard. The conspiracy in *Nazareth* is fiction (*supra*). The insolvency in *Nazareth* is irrelevant; *cf. McCandless*: "We have assumed in all this that the corporation was insolvent at the beginning of its business life. * * * Even though the company was not literally insolvent, the result would be the same."[17] *McCandless* did not involve disallowances in bank-

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[15] *Melville* v. *Kruse*, 174 N. Y. 306, 66 N. E. 965 (1903, *per* Werner, *J.*); *West* v. *People's First Nat. Bank & Tr. Co.*, 378 Pa. 275, 106 A. 2d 427 (1954, *per* Stern, *C. J.*); *see* 1 *Rowley on Partnership* (2d ed., 1960), § 6.3F; 2 *Id.* §§ 52.26-.28, 52.30, 52.33.

[16] *McCandless* v. *Furlaud*, 296 U. S. 140 (1935, *per* Cardozo, *J.*).

[17] *Id.*, 296 U. S. *at* 163.

ruptcy, or cancellation of stock for lack of consideration. Mr. Justice Cardozo's opening sentence reads: "The suit is by a receiver of an insolvent [Pennsylvania] corporation to compel its *promoters* and their *confederates* to restore illicit gains." [18] Though deciding a diversity suit in a New York federal forum prior to *Erie*, this Court did *not* rest on "general equity" alone, but also on the Pennsylvania Constitution and corporation statutes and cases which established a state cause of action in tort. Liability was imposed *only* on participants in the fraud. The equity receiver did *not* disclaim a corporate remedy in order to indemnify some of the creditors or stockholders for deceit in the promoters' public sales of securities. Rather, he sued as successor to the corporation, and asserted the corporation's right to restitution of diverted corporate assets. Indeed, the major legal problem was whether the corporation, as an entity, was entitled to a money judgment.[19] The realty had *not* been sold to the corporation at the promoters' cost, with the profit only on sales of the securities taken in exchange. Rather, the crux of the fraud was the promoters' sale of the realty to their new corporation at a price vastly in excess of their own cost and its fair market value.[20] The stock had been issued to the promoters for insufficient consideration, or for none; the value of the realty could not even support the bonds and notes. But subscriptions were *not* called, and the shares in public hands were *not* cancelled. In effect, the corporation's receiver undertook to collect the subscription price from the sellers of that stock—*not* from the innocent purchasers.

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[18] *Id.*, 296 U. S. *at* 149 (*emphasis supplied*). (*Quoted in* Wolf Brief *at* 40, 71)

[19] *Old Dominion Copper Mining & Smelting Co.* v. *Lewisohn*, 210 U. S. 206 (1908, *per* Holmes, *J.*) *distinguished* (296 U. S. *at* 157-164; *see* Roberts, *J., dissenting*, 296 U. S. *at* 171-3).

[20] *Accord*: *Getty* v. *Devlin*, 54 N. Y. 403 (1873, *per* Earl, *C.*); *s.c.*, 70 N. Y. 504 (1877, *per* Rapallo, *J.*).

"* * * What was done by the promoters here was in the teeth of a prohibition of the Constitution of Pennsylvania, * * *. True, *the securities are valid in the hands of innocent purchasers, whatever the consideration* [Pa. case cited], * * *.

"* * * Confusion of thought is inevitable unless the position of the wrongdoers as trustees is steadily kept in mind. What is here is something more than a tort of fraudulent misrepresentations to be redressed by the recovery of damages at the suit of the defrauded creditors. What is here is a tort growing out of the fraudulent depletion of the assets by men chargeable as trustees if they have failed to act with honor. There are important differences, moreover, between an over-issue of stock, which may leave the assets unimpaired, and a withdrawal of cash, which puts the enterprise in peril. [Cases cited.] The duty of reclaiming assets so diverted and holding the wrongdoers to their duty as trustees is one that rests on the receiver. * * *

"Furland and Kingston, having made themselves *parties to a scheme* whereby Duquesne was to be despoiled and its creditors were to be defrauded, became *accountable,* we think, for everything that came to them as a result of the conspiracy *in excess of the consideration* furnished on their side. * * * *The shares having been sold to others and the certificates being no longer subject to the mandate of the court, the trust that attached to them has been transferred to the proceeds,* which when paid to the receiver will be used like other assets in reduction of the debts." [21]

The respondents' new theories are evasions of the obvious. Malakoff acted as—and was—a stockholder-seller of Naz-

[21] *McCandless* v. *Furlaud, supra,* n. 16, 296 U. S. at 161, 163, 164 (*emphasis supplied*).

areth shares, as the District Court ruled. (Wolf Brief *at* 120-133.)

6. *Respondents' Naked Reliance on Two Erroneous Appellate Findings of Fact*: While they jettison Judge Moore's conclusions of law and rationale, the respondents cling to his opinion for two key findings of fact—and nothing more.

(a) *Tracing*: Judge Moore wrote:

> "Malakoff received the moneys put into his hands by the investors for the specific *purpose* of the allotment of shares in the Nazareth Market property. *He used some of this money to acquire that property.* * * * " (R. 593; *emphasis supplied*)

The Examiner had written:

> "* * * There is nothing in the record which establishes that any of these payments [by the 36 stock-claimants to Malakoff] became an asset of Nazareth *even indirectly.*" (R. 192; *emphasis supplied*)

(b) *Intention to Invest*: Judge Moore found an "intention" or "purpose" by 30 of the 36 stock-claimants to "invest" in Nazareth *because* those 30 had supposedly intended to acquire a direct share in the Market; the other 6 had bought what Malakoff purported to own, and *therefore* had no such "intention" to invest. In other words, if a man buys an original issue of AT&T stock, he "intends to invest" in AT&T; but if he buys his shares from another stockholder, he does *not* "intend to invest" in AT&T. Meanwhile, Judge Moore himself noted: "The Examiner treated * * * *each* claimant [of the 36] as having purchased his interest from Malakoff." (R. 592, *emphasis supplied*)

(c) *Rule 52(a)*: Respondents have hung their case on Judge Moore's findings of "tracing" and "intention", notwithstanding the appellate setting aside of the District Court's contrary findings of fact which were *not* "clearly

erroneous". Not a word is uttered in any of the three answering briefs about the appellate substitution of findings in the teeth of Rule 52(a), nor about the sheer arbitrariness, in terms and in application, of Judge Moore's classification of the 36 stock-claimants under his own posited findings. (*Wolf* Brief *at* 20-26, 115-120.) The District Court findings, not the Court of Appeals substituted findings, remain presumptively correct on review in the Supreme Court.[22]

7. *Respondents' Quest for New Appellate Findings of Fact*: The respondents' new rationales have thrown them back to the original record—almost 10,000 pages of testimony, plus hundreds of exhibits—to support such propositions as Malakoff's multiple trusts and agencies, the 36 stock-claimants' notice *vel non* of Malakoff's multiple conflicts of interest, the chimerical conspiracy between Malakoff and the Philadelphia Group, Malakoff's share of the joint venture, *etc.* Presumably, this Court will not re-try the case after 86 trial-days below, nor venture to assess the credibility of over 50 witnesses on issues raised here for the first time. However, two matters of fact posited by the respondents require reply, to illustrate the respondents' manipulation of evidence and the District Court's freedom from "clear error" in its findings, especially as to "tracing".

(a) *"Investments" and Windfalls*: The Court of Appeals gave some of the 30 prevailing stock-claimants more Nazareth "shares" than Malakoff had promised them and more than they had paid for. *E.g.*: Weinstein paid Malakoff $7,000 for 7/200 of Nazareth, or 3.5%. (R. 120-6) The decision below gives Weinstein $7,000/$145,987.34, or 4.795% (R. 594) —a 37% windfall over 3.5%. (Wolf Brief *at* 8-9, 47-8, 111, 123-8.)

"The small increase in the proportion of ownership, therefore, cannot be said to be a windfall," the respondents an-

[22] *McAllister* v. *U. S.*, 348 U. S. 19, *at* 20-21 (1954, *per* Minton, *J.*).

swer. (Fried Brief *at* 54.) Mr. Rosen gives the arithmetic: $7,000/$160,362 is "only" 4.365%. (Debtor Brief *at* 52-3.) Whence the $160,362 denominator used as the total of "investments"?

(i) It is simple arithmetic to add the allowances listed in Judge Moore's opinion. "Investments" by 31 of the 36 stock-claimants in No. 27000 (including $4,000 by Kanter) total $130,700. Add $9,000 and $6,287.34 in "investments" by Ida Mae Margolis and Shongut in No. 26962, for a grand total of $145,987.34. (R. 594-5, 598)

By contrast: The respondents represent total "investments" of $160,362.34. *Nine errors* appear from mere comparison of their Schedules with the Court of Appeals' list and order, *viz.*: (A) *Mintz*: Court, $0; respondents, $4,000. (B) *Graveson*: Court, $0; respondents, $4,000. (C) *D. H. Clark*: Court, $3,000; respondents, $2,875. (D) *Masur*: Court, $4,000; respondents, $3,900. (E) *M. Klein*: Court, $3,350; respondents, $1,200. (F) *Karapontso*: Court, $2,000; respondents, $0. (G) *Pollak*: Court, $9,000; respondents, $8,500. (H) *Laupheimer*: Court, $7,750; respondents, $8,000. (I) *H. Forman*: Court, $0; respondents, $11,000. Five stock-claimants' "investments" have been understated an aggregate of $4,875; one "investment" is overstated $250; and three persons omitted from Judge Moore's list are scheduled for an aggregate of $19,000. Thus have respondents evidenced a net increase of $14,375 over the total "investments" of $145,987.34 stated by Judge Moore and based on the District Court's findings. Hence the denominator $160,362.34, *Q. E. D.* (Compare R. 594-5, 598, *with* Fried Brief *at* 56-7, Debtor Brief *at* 65-6.)

(ii) The respondents' Schedules are erroneous not through sloppiness alone. (A) *Laupheimer*: Both Courts below disallowed $250 of Laupheimer's $8,000 "investment" claim. In February of 1951, he had invested $2,750 in a Malakoff deal unrelated to the unborn Nazareth project. In December of 1952, Laupheimer exchanged that old in-

vestment, plus a supposed $250 profit thereon, for 3 shares of Nazareth stock. (The other $5,000 was advanced to Malakoff in October of 1951 for 5 Nazareth shares.) "[Laupheimer] does not contend that he invested more than $7,750 in Nazareth." (R. 120) Nevertheless, the respondents have scheduled Laupheimer's investment exchange of $2,750 and his profit of $250 thereon as direct "investments" of $3,000 in Nazareth. (R. 114-120; *cf.* R. 594; *see* Wolf Brief *at* 116.) (B) *Harry Forman* claimed an "investment" of $11,000 in Nazareth. The District Court allowed him only $10,000: "The sum of $500 was repaid and the bonus of $500 should be deducted." (R. 142) Forman's $10,000 advances to Malakoff in March and April of 1953 were personal loans to Malakoff, secured by Nazareth stock. (R. 136-142) Therefore, the Court of Appeals allowed Forman nothing. (R. 596) Nevertheless, the respondents have scheduled Malakoff's antecedent debts of $10,000 to Forman as direct "investments" of $11,000 by Forman.

(iii) The respondents' scheduling of *Mintz* and *Graveson* as "investors" of $4,000 each, is the nadir. Mintz and Graveson are phantoms. They never filed claims, and they never testified. The names appear in Malakoff's notebook on the same page (R. 547) as the names of Kanter, G. S. Klein, and Samet. (*See* R. 230, 56, 58-60) The cryptic notebook page is the scintilla of evidence relied upon by respondents at this stage to account for the "investments" of Mintz and Graveson. The same scintilla, on its face, also accounts for Malakoff's repayment of those "investments" to Mintz and Graveson prior to his "new deal" in July of 1951. (R. 547, 231, 52)

(iv) The District Court found that Malakoff had advanced $12,489 to the Philadelphia Group on or before April 17, 1951 (when the Philadelphia Group took title to the Market), and another $5,000 on or before May 8, 1951. (R. 56; *see* R. 589) Nevertheless, Mr. Rosen says that Malakoff's first advance to the Philadelphia Group occurred on June 26,

1951, and that Malakoff's advances to the Philadelphia Group aggregated $17,489 not earlier than August 18, 1951. (Debtor brief *at* 67.) Both Courts below found, and Mr. Rosen concedes, that "investments" by stock-claimants (not by strangers) prior to August of 1951 aggregated only $8,500. (*Id. at* 65)

The respondents' scheduling of Mintz and Graveson for $8,000 in "investments", obscures Malakoff's own "investment" of $9,489 prior to August of 1951, and obscures the full 37% windfall to Weinstein.

(b) *Insolvency*: In the District Court and the Court of Appeals, Mr. Rosen was the vigorous proponent that all the Nazareth stock was void for lack of consideration to the issuer. (R. 47-9) Therefore, he argued, the corporation and the outstanding shares should be disregarded. Judge Moore adopted that proposition. Now Mr. Rosen has abandoned it. Instead, he theorizes that the stock, though valid, was worthless, because Nazareth was insolvent at all times from incorporation to Chapter X commencement. Therefore, he still argues, the corporation and the outstanding shares should be disregarded.

(i) Sometimes Mr. Rosen defines "insolvency" as an excess of *current* liabilities over *current* assets. (Debtor Brief *at* 8) The corporation's principal assets—land and buildings—are simply ignored. (ii) Sometimes Mr. Rosen acknowledges the statutory definition of "insolvent", *viz.*: "• • • whenever the aggregate of his property • • • shall not *at a fair valuation* be sufficient in amount to pay his debts."[22a] Nevertheless, he uses *book value* alone. (iii) Malakoff's consideration to Nazareth for the outstanding stock, about $60,000, appears on the Nazareth books as "loans payable", not as "capital". On July 2, 1953, Malakoff released his claims to those "loans payable" and effectually capitalized them. Mr. Rosen's failure to capitalize "loans payable" to

[22a] Bankruptcy Act, § 1(19); 11 U. S. C. § 1(19); 52 Stat. 840 (1938).

Malakoff *on the books, alone* accounts for the posited book insolvency even by Mr. Rosen's novel definitions. (iv) The Debtor's petition for reorganization—verified by Weinstein as president, certified by Mr. Rosen as attorney, and filed on September 28, 1953—annexes a balance sheet based on the Nazareth books and showing: *capital*, $1,500; *earned surplus* (after depreciation reserve of $8,424.81), $7,349.37; *reserve for taxes*, $3,674.69; total, $12,524.06. (R. 13-14, 191, 513-8; Wolf Brief *at* 15-17, 90-94.)

8. *Assessment Prerequisite to Forfeiture of Stock to Issuer*: Under Pennsylvania law, assessment or call is prerequisite to cancellation or forfeiture of corporate shares for lack of consideration to the issuer. (Wolf Brief *at* 94-99.)

(a) The respondents have not so much challenged Wolf's statements of Pennsylvania law, as they have changed them. When Wolf speaks of assessment as a *prerequisite* to cancellation (*ibid.*), the respondents speak of a "substitute" for cancellation (Fried Brief *at* 49). When Wolf speaks of lack of consideration to the issuer (*i.e.*, a stockholder's failure to pay a subscription), respondents speak of fraud to a stockholder (*i.e.*, a fiduciary's diversion of valid, fully-paid stock). Wolf noted the express Pennsylvania law on transfers of subscriptions and on liability of transferor and/or transferee to call or assessment (Wolf Brief *at* 96); respondents say (on no reason or authority) that only a direct subscriber is liable to call or assessment (Fried Brief *at* 49). Wolf noted the corporation's right to cancellation or forfeiture of stock for lack of consideration and/or for overissue alone. Respondents say "equitable cancellation of stock unlawfully issued" is available—*incident to re-issue of the same valid shares*—to a stockholder given a decree of restitution or specific performance against a title-holding fiduciary who defrauded the stockholder, not the corporation.[23] The respondents' theories must confuse a contest

[23] *Fraser Fund* v. *Fraser*, 350 Pa. 553, 40 A. 2d 22 (1950, *per* Stearne, *J.*); *Shipley* v. *Monticue Lines*, 4 Fayette L. J. 293 (C. P., Fayette, 1941, *per* Dumbauld, *P. J.*). (*Cf.* Fried Brief *at* 47.)

among stockholders over ownership of shares, with a contest between corporation and stockholder over validity of shares. Their theories must abuse the captive corporation in order to reduce the total number of valid shares outstanding.

(b) The respondents themselves are at odds (again) on whether the Court of Appeals "cancelled" the stock of the 6 aggrieved stockholders. (*Compare* Fried Brief *at* 45, *with* Debtor Brief *at* 46, 2d fn.)

(c) In disputing the prerequisite of call or assessment prior to forfeiture of stock for lack of consideration, the respondents rely on a repealed statute and a *dictum*. (Fried Brief *at* 43-44, 48.) The repealed statute is § 131 of the old Pennsylvania corporation law,[24] enacted in 1874, repealed in 1933, and in force when the cause of action arose in *McCandless* v. *Furlaud*.[25] The respondents quoted part of § 131 and the first sentence of § 603A [26]—*part* of the 1933 successor "implementing" statutes. The reader may note from those quotations that the Pennsylvania legislature omitted from § 603A (and the rest of the "implementing" statutes) the key words, "all fictitious increase of stock * * * shall be void". Those key words were then, and still are, contained in the Pennsylvania Constitution.[27] They are the words referred to in Mr. Justice Cardozo's *dictum* (relative to *Nazareth*) that "there exists * * * an 'implementing' statute [citing § 131], without restriction as to the form of the remedy." [28]

(d) At last, the respondents resort to analogy to foreign law. "The Constitutions of Arizona and Oklahoma contain

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[24] 15 Purdon's Pa. Stats. Ann. § 131; P. L. 73, § 17 (1874), *amended* P. L. 30, § 4 (1876), *repealed* P. L. 364, art. XII, § 1202 (1933).

[25] *McCandless* v. *Furlaud*, 296 U. S. 140 (1935, *per* Cardozo, J.).

[26] Pa. Bus. Corp. L. § 603A; 15 Purdon's Pa. Stats. Ann. § 2852-603A; P. L. 364, art. VI, § 603A (1933).

[27] Pa. Const., Art. XVI, § 7 (1874, *amended* 1956).

[28] *McCandless* v. *Furlaud*, *supra*, n. 25, 296 U. S. *at* 161.

provisions similar to those of Pennsylvania with reference to the issuance of stock" (Fried Brief *at* 50). So do the constitutions and/or statutes of 48 of the 50 states of the Union.[29] The respondents cite cases under the corporation laws of 12 states outside Pennsylvania (*Id.* at 46-52). Typical is the New York case where the court cancelled outstanding stock on the ground that "Stock may be issued for property or work done, but not for services to be rendered in the future."[30] As to the *grounds* for forfeiture of stock, that is the law of most states.[31] It is *not* the law of Pennsylvania (as the respondents themselves note amid their analogizing).[32] As to the *remedy* for lack of consideration, likewise, it is *not* the law of Pennsylvania. (Wolf Brief *at* 94-99) Indeed, later this year, it will no longer be the law of New York, when the Model Business Corporation Law becomes effective. The new statute contains some provisions similar to the existing provisions of Pennsylvania law requiring assessment prior to cancellation.[33] The New York

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[29] *See* Herwitz, Allocation of Stock Between Services and Capital in the Organization of a Close Corporation, 75 Harv. L. Rev. 1098, *at* 1099, n. 3 (1962).

[30] *B. & C. Elec. Const. Co.* v. *Owen*, 176 A. D. 399, 163 N. Y. S. 31, *at* 32 (4th Dept., 1917, *per* Kruse, *P. J.*), *affd.* 227 N. Y. 569, 126 N. E. 927 (1919). The Court added, "While a certificate of stock regular upon its face, issued by officers or agents having authority to issue stock for the corporation, may in the hands of an innocent transferee become effective, * * *, this certificate in the hands of the original holder was valueless. It was, in effect, like so much blank paper." 163 N. Y. S. *at* 32. *But see Morgan* v. *Bon Bon Co., Inc.*, 222 N. Y. 22, 118 N. E. 205 (1917, *per* Hiscock, *C. J.*).

[31] *See Herwitz, op. cit. supra*, n. 29.

[32] *Petrishen* v. *Westmoreland Finance Corp.*, 394 Pa. 552, 147 A. 2d 392 (1959, *per* Jones, *J.*); *Grafton* v. *Masteller*, 232 F. 2d 773 (3d Cir., 1956, *per* Hastie, *J.*), *cert. den.* 352 U. S. 832 (1956). *See* Wolf Brief *at* 92-5; *cf.* Fried Brief *at* 49.

[33] N. Y. Bus. Corp. L. (6 McKinney's N. Y. Consol. L.) § 503(d); L. 1961, c. 855, § 503(d), *amended* L. 1962, c. 334, § 12, *eff.* 9/1/63.

Reviser's Comment thereon states: "* * * The harsh forfeiture provision of Stock Corp. Law § 68 has been softened * * * by a requirement * * * for a sale of the shares of a delinquent subscriber * * *."

The whole thrust of *Erie* was that state laws differed, and that the federal courts were not to substitute their own conceptions of "reason" and "equity" for state case-law, particularly state-court interpretation of local statutes.

9. *The Debtor as Tool and Meddler—Res Judicata and Incapacity on Appeal*: Mr. Rosen has pierced the corporate veil: by his appearance, he has disregarded the corporate entity of the Debtor, his client. Though a self-professed devotee of *McCandless* v. *Furlaud*,[34] he will not distinguish between a corporation's cause of action and its stockholders' individual causes of action. If this Court affirmed the decision below and granted the relief sought by Messrs. Rosen, Weinstein and Fried, the Debtor would derive no gain or benefit. If this Court reversed the decision below and granted the relief sought by Wolf, the Debtor would suffer no loss or prejudice. Mr. Rosen's very appearance (not to speak of his joint-venture theory) is an essay in anomaly.

(a) Mr. Rosen's theory would raise two causes of action in behalf of the Debtor.

(i) *Fraud:* Mr. Rosen says that Malakoff diverted $101,366 of $160,362 in "investments" which should have reached the Nazareth treasury. (Debtor Brief *at* 67.) Mr. Rosen was retained by the Debtor on July 13, 1953 (R. 188), and by the Debtor in Possession on September 28, 1953 (when the Chapter X petition was filed and approved). (A) In almost two years before Malakoff's death, the Debtor never sued Malakoff. (B) Helen Bernstein was Malakoff's

[34] *McCandless* v. *Furlaud*, 296 U. S. 140 (1935, *per* Cardozo, *J.*).

general agent; much of the "diverted" $101,366 passed through her hands. (R. 192, 231) In almost ten years, the Debtor never sued Helen Bernstein. (C) Mr. Rosen says the Philadelphia Group conspired with Malakoff and participated in his frauds. In almost ten years, the Debtor has never sued any member of the Philadelphia Group. (D) The Debtor's balance sheet annexed to the Chapter X petition, shows "Accounts Receivable—J. Malakoff, $11,811.75" (R. 13), *i.e.*, the windstorm insurance proceeds received by the Philadelphia Group. (R. 191, 589) Those moneys Mr. Rosen treats as Nazareth's, disregarding credit to Malakoff. (Debtor Brief *at* 38.) The Debtor still carries that item as a "current asset." (R. 522) In almost ten years, the Debtor has never sued to collect it. (E) In the District Court, Mr. Rosen charged some of the 36 stock-claimants with conspiracy and participation in Malakoff's fraud. (R. 47-49) He brought counterclaims against only two, Hull and Fried, and against none of the 6 aggrieved stock-claimants. Hull was exonerated of participation in or knowledge of Malakoff's frauds, in fact. (R. 145-6) No such finding was made with respect to Fried. (R. 157-8) Nevertheless, Mr. Rosen undertook to "compromise (*i.e.*, to drop) the Debtor's counterclaims against Fried. (303 F. 2d 152; *see infra*, pp. 32-34.)

(ii) *Assessment:* Under the respondents' own theories, and using their own figures, the only consideration Nazareth actually received for any valid outstanding shares, was $58,996, the total "investments" traced into the Market conveyed to Nazareth. The balance—$101,366—of total "investments" of $160,362, did *not* reach Nazareth in money or property, because "diverted" by Malakoff. (Debtor Brief *at* 67.) The true stock-claimants (whoever they are) who paid Nazareth (contradistinct to Malakoff) $58,996 for their stock, would have their "shares" diluted by allowance of additional "shares" for $101,366. Of the total shares of $160,362 which the respondents would validate, nearly 5/8 would be issued

for *no* "money, labor done, or money or property actually received" [34a] by Nazareth as issuer.

Weinstein and Fried, acting individually and as representatives of the 30 prevailing stock-claimants, argue "estoppel" against Nazareth to support the allowance of 5/8 of the stock without consideration. Mr. Rosen does *not* take issue with that affirmative defense of estoppel asserted against Nazareth, his own client. On the contrary, he argues still another theory ("piercing the corporate veil" *etc.*) to rationalize the identical result and thus affirmatively to support Weinstein and Fried. Meanwhile, he steadfastly rejects a remedy of assessment in favor of cancellation, despite the Pennsylvania law which empowers—and requires—the Debtor's assessment prior to cancellation.

If Nazareth would suffer a loss by the validation of $101,366 in stock without consideration to Nazareth, Mr. Rosen has aligned himself and his client (Nazareth) with an adverse interest. If Nazareth would not suffer a loss by such validation, then neither would Nazareth suffer a loss by validation of the shares of the 6 aggrieved stock-claimants, too.

(b) Mr. Rosen would justify his appearance by claiming the standing of an *amicus curiae*. He would justify the Debtor's (*i.e.*, his) failure to appeal in No. 27000 by lack of authorization from Philip and Danciger (then the two Nazareth directors in addition to Weinstein):

> "* * * The Board of Directors, controlled by Philip and Danciger, did not authorize Debtor's attorney to appeal * * *. [Mr. Rosen] did submit a brief stating the Debtor's position * * *. Weinstein, however, as President, *in the interests of the Debtor* has authorized the printing of this brief to the Court of Appeals [citation]. Weinstein, as President, instructed Debtor's attorney to take an *impartial and disinter-*

[34a] Pa. Const., Art. XVI, § 7 (1874, *amended* 1956).

> *ested position* irrespective of who might be hurt [citation]. Fortunately, others [*viz.*: Weinstein and Fried] had appealed * * * and Debtor had an opportunity, as appellee, to present its version * * *." (Debtor Brief *at* 55; *emphasis supplied.*)
>
> "* * * [Philip and Danciger] acted in complete disregard of the duty imposed on Debtor's attorney, *as its representative,* to object to the allowance of improper claims [citation] and to report to the judge (in this case the Court of Appeals) as to any *causes of action available to the estate* [citation]. * * *" (*Id. at* 56; *emphasis supplied.*)

(i) Mr. Rosen did not file notice of appeal for the Debtor in No. 27000 in January, 1961. He did file notice of appeal for the Debtor in No. 26962 (Margolis Group) in April, 1961. (R. 587) He filed briefs in both, and in No. 26362 (removal and compensation). He had no authority from the directors to file notice of appeal or briefs in any of the three cases. Fried appealed in all three. Under Mr. Rosen's argument, Fried's appeal alone would have given Mr. Rosen the same bootstrap in No. 26962 that Mr. Rosen seized in No. 27000. The Debtor's appeal in No. 26962 in April, 1961, and the Debtor's briefs in all three cases, belie Mr. Rosen's explanation of the Debtor's failure to appeal in No. 27000.

(ii) On November 6, 1961 (three days before the Court of Appeals' decision in No. 27000), the District Court denied a petition of the Debtor's for payment of $1,005.02 out of the estate for Mr. Rosen's briefs in No. 27000 in the Court of Appeals, and effectually surcharged Mr. Rosen individually, as a volunteer, for the cost of those briefs. (Mr. Rosen did not appeal.) (Debtor Brief *at* 55.) There are three sound reasons for the District Court's order on printing costs. (A) The Debtor, *qua* appellee, had *no right* to attack the District Court's judgment. (Wolf Brief *at* 100.) (B) The

Debtor had *no authority* to litigate in the Court of Appeals. Though its president, Weinstein, would normally have independent power to authorize litigation in the corporate name and at corporate expense, his power had been duly contained by the express prohibition of the directors against litigation without the board's prior consent.[35] Neither Weinstein nor Mr. Rosen had even asked the other two directors (Philip and Danciger) for consent. Weinstein's authorization was insufficient. (C) The Debtor derived *no benefit* from appeal or argument in No. 27000. The Debtor could benefit only from assessment or restitution—which Weinstein and Mr. Rosen disclaimed, and which the Court of Appeals did not order. (Wolf Brief *at* 100, n. 112.)

(c) By now, no one claims that the 6 aggrieved stock-claimants are liable for restitution. By now, even Messrs. Rosen, Weinstein, and Fried concede that Nazareth received consideration for some outstanding shares. Mr. Rosen asks the Court to disregard the *res judicata* doctrine—not because he seeks assessment, but because he seeks cancellation. With no prospect of a money judgment in favor of the Debtor—and with no prayer therefor by anyone—the Debtor (contra-distinct to its incumbent management) can have no interest in the ownership of its valid, fully-paid, non-assessable, outstanding shares of stock, however fractionalized. Whether the valid Nazareth shares were owned by 36 stock-claimants, or by 30, or by one, should be immaterial to the Debtor—and to Mr. Rosen.

In sum, under Mr. Rosen's tutelage, the Debtor has affirmatively rejected and abandoned every opportunity and obligation (under Mr. Rosen's own theory) to add to the Nazareth treasury. Instead, every cause of action of the Debtor's has been misappropriated by Messrs. Weinstein,

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[35] *See West View Hills, Inc.* v. *Lizau Realty Corp.*, 6 N. Y. 2d 344, 189 N. Y. S. 2d 863 (1959, *per* Dye, *J.*); Goebel, Authority of the President over Corporate Litigation, 37 St. John's L. Rev. 29 (1962).

Fried, and Rosen, with a view to cancelling Nazareth shares —to protect and increase the individual equity and votes of Weinstein and Fried in Nazareth, at the expense of the Debtor corporation. The Debtor, as a distinct corporate entity, is a meddler in No. 27000, without standing. Its use as a captive and tool, can be understood only by reference to No. 26362.

No. 26362—The Respondents' Fraud

1. *Fried's Race-Track and Res Judicata*: Weinstein and Fried argue that the race-track matters alleged by Wolf as alternative grounds for relief in No. 26362, were dismissed on the merits by the Court of Appeals during the pendency of No. 26362, and therefore are foreclosed from this Court's consideration. (Fried Brief *at* 5, 24.) The argument is erroneous.

The race-track rent reductions and diversions were the subject of another petition brought by Wolf, seeking (*inter alia*) an accounting of the rents. Judge Sugarman severed that petition from the removal petition involved in No. 26362. The race-track accounting petition was tried in November, 1960, and decided on June 28, 1961. An order was entered on September 12, 1961. The cross-appeals by Fried and Enterprises (his race-track corporati) and by Wolf, became No. 27248 in the Court of Appeals. During the pendency of No. 27248, and on November 9, 1961, the Court of Appeals decided Nos. 26362, 26962, and 27000 (two of the three cases constituting No. 70 in this Court). By November 29, 1961, when Wolf's petitions for rehearing below were denied, Nazareth appeared to have new stockholders, and Weinstein and Fried appeared to be free to hold office in Nazareth. (Wolf Brief *at* 29-30, 33-7, 165-7, 186a-189a.)

New directors and officers of the Debtor were elected and approved in December. In January of 1962, Fried and his

race-track corporation made an omnibus offer in compromise; they proposed an exchange of releases of all the claims and counterclaims, arising both before and during the Chapter X proceeding, between Fried and his corporation on the one side and the Debtor on the other side. The Debtor accepted the "compromise" and petitioned the District Court for approval. Only the Debtor (*qua* trustee) had authority to petition for compromise in bankruptcy.[36] Only upon new election of directors was the Debtor authorized to do so. On February 5, 1962, the District Court granted the compromise petition (as modified somewhat at the hearing), and expunged (*inter alia*) the Debtor's claim for the race-track back-rents. The Debtor and Fried then moved the Court of Appeals to dismiss Wolf's race-track appeal (No. 27248) as moot. Wolf appealed from the compromise order (No. 27464). The latter appeal (No. 27464) and the motions to dismiss the former appeal (No. 27248) were consolidated and expedited, and were argued together on March 28, 1962. On April 2, 1962, this Court granted *certiorari* in No. 26362 and No. 27000. (R. 602) On May 14, 1962, the Court of Appeals reversed the District Court in No. 27464, holding the February 5th compromise order an abuse of discretion. The Court of Appeals also vacated—not reversed—the District Court's race-track order in No. 27248, and remanded the entire matter of the race-track and the Debtor-Fried claims and counterclaims, to abide this Court's decisions in No. 26362 and No. 27000.

> "In view of the fact that the Supreme Court has granted certiorari in Weinstein v. Wolf [No. 26362], and Fried v. Margolis [No. 27000], we think it wise for the District Court to refrain from making any final determination concerning the proposed compromise until the Supreme Court announces its decision

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[36] *Bankruptcy Act*, § 27, 11 U. S. C. § 50, 52 Stat. 955 (1938); General Order 33, *f. Bankruptcy Act*, § 30. (*See* Wolf Brief *at* 65, n. 52.)

in these cases which could affect the ownership and control of the Debtor as well as *Fried's debts to the corporation.*

"We are entirely in accord with the purpose of the District Court to bring an end to this seemingly endless litigation. We think it best therefore to *remit* both appeals so that the District Court may finally dispose of the *entire set of claims and cross-claims* after the Supreme Court has spoken. To this end we *vacate* the judgment in Appeal No. 27248 and remand to the District Court for such action as it may deem proper. Reversed and remanded on both appeals." [37]

2. *Respondents' Indignation*: Weinstein and Fried affect indignation at Wolf's charges of fraud.

(a) In speaking of the Weinstein-Fried purchases of Nazareth stock during the proceedings, Weinstein denies that he "made a single cent of profit out of the purchase of stock." (Weinstein Brief *at* 11-12.) Of course: the stock has not been re-sold; and most was bought by Weinstein for Fried and others. (Wolf Brief *at* 8-9, 31-33.) Weinstein and Fried later admit a "small increase in the proportion of ownership" of Nazareth—on the stock they bought from Malakoff in 1951, and on the stock they bought from other stockholders during the Chapter X proceeding. (*Id.*; Fried Brief *at* 54, *adopted by* Weinstein Brief, *at* 2.) They merely deny the increase was a "windfall."

(b) In speaking of the District Court's order that Fried and Enterprises (his corporation) account for race-track rents belonging to the Debtor, Fried says the District Judge "found no diversion from the Debtor of any rental either by Fried or by Weinstein." (Fried Brief *at* 23.) By Fried's own figures, and pursuant to the District Court's limited

[37] *Wolf* v. *Nazareth Enterprises, Inc.*, 303 F. 2d 152, *at* 155 (2d Cir., 1962, *per* Smith, *J.*) (*emphasis supplied*).

order, Fried—with Weinstein's approval—took at least $23,996.77 in rents from the Debtor during the proceedings. They admit the taking. (Wolf Brief *at* 33-37, 186a-189a.) They merely deny the taking was a "diversion."

(c) Weinstein complains of Wolf's phrasing of the Questions Presented to the Court in No. 26362, particularly the references to fiduciaries' "diversions of the debtor's rents to *themselves* during the proceedings." (Wolf Brief, *at* 3, 50.) The word "themselves" is conclusory, like "diversions." To the injured Debtor (and to Wolf representatively), the distribution of the fruits among the wrongdoers is immaterial; it raises no question of law. Two fiduciaries who participate together, inseparably, actively, and deliberately, in a wrong to their principal, are liable for restitution *and* indemnity, jointly and severally.[38] The gravity of the wrongdoing is demonstrated by criminal liability as well as civil liability, willy-nilly personal profit to the accessory.[39]

Weinstein's indignation rises from his obdurate misconception of the law. He supposes that his forgoing a share of the Debtor's diverted property, excuses his diverting the Debtor's property to Fried. Wolf has never charged Weinstein with sharing with Fried in the diverted rents; for there is no such evidence. So Weinstein acknowledges. Wolf's Brief (33-37, 165) was intended to make that clear. But forgoing a share is only evidentiary, and is only relevant where participation is an issue of fact; "a showing of pecuniary interest [is] unnecessary to proof of a stake in the venture."[40] There is no such issue of fact here as to Weinstein's participation—as businessman and trustee, not as lawyer. Weinstein and Fried have admitted their diversions

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[38] *Mosser* v. *Darrow*, 341 U. S. 267 (1951, *per* Jackson, *J.*) (*quoted in Wolf* Brief *at* 181). *See also General Rubber Co.* v. *Benedict*, 215 N. Y. 18, 109 N. E. 96 (1915, *per* Cardozo, *J.*).

[39] *U. S.* v. *Knight*, 336 U. S. 505 (1949, *per* Douglas, *J.*) (*quoted in* Wolf Brief *at* 181).

[40] *U. S.* v. *Blazer*, 309 F. 2d 92, *at* 93 (2d Cir., 1962, *p. c.*).

of the race-track rents. An issue of law remains—evaded by the District Court and the Court of Appeals. Now Weinstein and Fried would have this Court evade the issue, too, by the sophistry of *res judicata* and mootness, by carping about words like "windfall" and "diversions" and "themselves", and by pleading "motive". "Conduct and purpose have a quality imprinted on them by the law."[41]

3. *Rehrig and Philip*: To account for their own misconduct, the respondents attack Rehrig and Philip (Wolf's principals).

(a) The respondents say that Philip bought stock while a director and officer of Nazareth. (Fried Brief *at* 25.) *That is not true.* Philip was elected a director and officer on August 4, 1958. Notwithstanding the unanimous vote of the stockholders (including Weinstein and Fried, voting their own shares and the proxies they had solicited), the respondents opposed Philip's (and Danciger's) election, and delayed confirmation by Judge Sugarman until June 14, 1960—almost 22 months later. (R. 226-7, 495-6.) Philip did not and could *not "become* an officer or director of the debtor • • • without the prior approval of the court."[42] Section 249 applies to a person "who at any time *after assuming to act* in such [fiduciary] capacity has purchased or sold • • • stock • • •."[43] Philip did *not* participate in Rehrig's purchase of Seymour Forman's stock in December of 1960—the sole purchase of Nazareth stock by anyone in the Rehrig Group after June 14, 1960, when Philip first became and acted as director and officer.

(b) The respondents say they were protecting Nazareth, by their stock purchases, from Rehrig's quest for control of

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[41] *Shapiro* v. *Wilgus*, 287 U. S. 348, *at* 357 (1932, *per* Cardozo, *J.*).

[42] *Bankruptcy Act*, § 191; 11 U. S. C. § 591; 52 Stat. 893 (1938) (*emphasis supplied*).

[43] *Bankruptcy Act*, § 249; 11 U. S. C. § 649; 52 Stat. 901 (1938) (*emphasis supplied*).

Nazareth and for a "preferential" lease. In the same breath, they deny their stock purchases were designed to perpetuate their own control of Nazareth and to assure Fried's lease (with rent reductions and diversions). (*See* R. 466-7; Wolf Brief *at* 10.) They presume their illegal stock purchases were indispensable to avoid a "preferential" lease to Rehrig. They ignore the Court's control of Rehrig's lease, as they ignored the Court's control of Fried's lease.[44] They ignore the standing of any stockholder to object to a "preferential" lease, as Wolf has objected to the preferences to Fried.[45]

They quote Rehrig's statement that he considered $10,000 per year a fair rent for the space he then occupied, rather than the $15,000 per year he was then paying, as proof of Rehrig's intent to rape the Debtor. (R. 445) Rehrig expressed a frank opinion of fair rental value of his *space*. Events have proved his opinion correct. After his lease expired on August 31, 1961, he remained a tenant at will, paying the same $15,000 per year. On May 13, 1962, fire damaged the grandstand building occupied by Rehrig and others, and destroyed the fixtures Rehrig had installed and paid for. The Debtor's repairs took months. Rehrig no longer needed to pay an excessive rent for his space to preserve his lost good-will and fixtures. He is no longer a tenant. The Debtor now has only the *space* to lease. Weinstein and Fried have solicited Rehrig's return at $15,000 per year—unsuccessfully. The space Rehrig had occupied has been vacant, and unproductive to the Debtor, since the fire last May.

(c) The *ad hominem* attacks on Rehrig and Philip are not only untrue, but immaterial and a smokescreen.

> "Nor can we sustain the contention that relief should be denied on the allegations that Young's

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[44] *Bankruptcy Act*, § 116(3); 11 U. S. C. § 516(3); 52 Stat. 885 (1938).

[45] *Bankruptcy Act*, § 206; 11 U. S. C. § 606; 52 Stat. 894 (1938).

[petitioner's] motive in bringing the [restitution] proceeding is an unworthy one. His petition sought relief for the benefit of all the stockholders. The rights of these stockholders are not to be ignored because of some motive attributable to Young." [46]

4. *Vitality of § 249*: The Sixth Circuit has joined the First, Second (except for *Nazareth*), Third, Fourth and Seventh Circuits in interpreting and applying § 249 in accordance with its plain meaning and its legislative history. *In re Inland Gas Corp.*, 309 F. 2d 176 (6th Cir., 1962, *per* Miller, *C. J.*). (*See* Wolf Brief *at* 142-4.)

5. *The Debtor as Tool and Meddler—Incapacity on Appeal*: The Debtor's name and moneys have been committed to a brief in support of Weinstein and Fried individually, in No. 26362 as well as No. 27000. (Debtor Brief *at* 61-64) Wolf's petitions in No. 26362 are representative. "The corporation can take no position in a derivative stockholder's suit which is fundamentally antagonistic to the claim asserted on its behalf." [47]

Dated: New York, New York
February 14, 1963

Respectfully submitted,

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[46] *Young* v. *Higbee Co.*, 324 U. S. 204, *at* 214 (1945, *per* Black, *J.*).

[47] *Carthage Paper Makers, Inc.* v. *Mutual Box Board Co.*, 159 N. Y. S. 2d 659, *at* 661 (Sup., Oneida, 1956, *per* Gorman, *J.*), *aff'd.* 3 A. D. 2d 640, 158 N. Y. S. 2d 790 (4th Dept., 1956, *memo*); *see Ballantine on Corporations* (1946), § 154.

ERRATA

(In Wolf Brief dated 11/26/62, filed 11/30/62)

Page xxvii, 6th citation: *Substitute* "Visitorial"

Page 8, line 21: *Add* "Ann Rosen" after Pollak

Page 29, 4th line from bottom: *Delete* "Weinstein"

Page 61, note 42, line 8: *Substitute* "served" for "saved"

Page 61, note 42, line 12: *Substitute* "No. 26962"

Page 66, 3rd par., line 6, 8th word: *Substitute* "misused"

Page 117, 2nd par., line 3: *Substitute* "pp. 21-23"

Page 119, line 6: *Substitute* "pp. 24-26"

Page 127, par. (i), line 7: *Substitute* "pp. 24-26"

Page 165, 1st par., line 11: *Substitute* "pp. 33-37"

Page 165, 1st par., line 17: *Substitute* "p. 33"

Page 170, line 10: *Substitute* "pp. 30-31"

Page 181, last line of quotations: *Substitute* "of forbidden acts, * * *." [309]

Page 221a, § 164, 1st line of text: *Italicize "or in article 6-A"*

Page 53, n. 32, *and* Page 199a: *Add* to citation of § 247: "Amended, P. L. 87-681, § 13; 76 Stat. 570 (1962)."